EDWARD L. JOHNSON

IBLA 85-616 Decided September 18, 1986

Appeal from a decision of the New Mexico State Office, Bureau of Land Management, rejecting the high bid for competitive oil and gas lease NM 55019(OK).

Set aside and referred for a hearing.

1. Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases: Discretion to Lease

   A BLM decision rejecting a high bid in a competitive oil and gas lease sale as inadequate will be affirmed if the record indicates the decision has been made in a careful and systematic manner utilizing the advice of the experts employed by the Department for making such determinations. A showing of a rational basis for the conclusion that the highest bid does not represent fair market value is sufficient.

2. Administrative Procedure: Burden of Proof -- Evidence: Burden of Proof -- Oil and Gas Leases: Generally -- Oil and Gas Leases: Competitive Leases -- Rules of Practice: Appeals: Burden of Proof

   A party appealing a rejection of a bid submitted in a competitive oil and gas lease sale because the bid has been found to be less than the fair market value has the affirmative obligation to prove the Government estimate was inaccurate and the bid submitted represents fair market value.

4. Administrative Procedure: Hearings -- Evidence: Sufficiency -- Hearings -- Rules of Practice: Hearings

   Where there are disputed facts determinative of the legal issues posed therefrom, this Board has the discretionary authority to order a hearing on the matter before an Administrative Law Judge pursuant to 43 CFR 4.415.

APPEARANCES: Edward L. Johnson, pro se.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

Edward L. Johnson appeals from a decision of the New Mexico State Office, Bureau of Land Management (BLM), dated April 16, 1985, rejecting his bid for NM 55019(OK) for the second time. Appellant's high bid of $2,016 ($64.41 per acre) was submitted for parcel 53 1/ at a competitive oil and gas lease sale held October 27, 1982.

BLM had previously rejected the bid by decision dated December 22, 1982, because the bid was found to be insufficient based on presale evaluations. BLM appended a memorandum prepared by the Minerals Management Service (MMS), 2/ to that decision in an attempt to explain its rejection. The memorandum showed various factors and "input data values" used to evaluate the parcel, but it did not include the amount of the presale evaluation. The file also contained a rebuttal memorandum from the Acting Deputy State Director for Minerals, New Mexico State Office, BLM, dated April 25, 1983, addressing concerns appellant raised regarding the initial rejection. A copy of this rebuttal memorandum was served on appellant during the course of his appeal from BLM's first decision. In Edward L. Johnson, 73 IBLA 253 (1983), the Board found the case record inadequate and the case was remanded to BLM for readjudication of the bid. In its decision the Board stated:

> A post-sale evaluation will be made, and appellant's bid will be re-adjudicated on the basis of the figure thus derived. Should the bid again be rejected, the record submitted to this Board on appeal shall be complete, with no omissions, exclusions or deletions of any documents or data, and will specifically include all actual amounts of pre- and post-sale evaluations. Should such record contain any information which is prohibited by law from public disclosure, it should be so identified. However, no record of this Department may be treated as immune from Secretarial review on appeal. [Emphasis omitted.]

73 IBLA at 257.

After remand, the BLM Southeast Region Evaluation Team prepared an additional memorandum, dated April 15, 1985, incorporating the earlier rebuttal and recommending rejection of appellant's bid. The evaluation team stated:

> The presale estimated amount for bonus value was $31,300.00 total or $1,000.00 per acre. The [appellant's] high bid for

1/ The land includes 31.3 acres, an area described by metes and bounds making up lot 4 sec. 3 in T. 16 N., R. 26 W., Indian Meridian on the bank of the Canadian River in Roger Mills County, Oklahoma.
2/ MMS assumed the minerals related functions of the Conservation Division of Geological Survey under the provisions of Secretarial Order No. 3071 dated Jan. 19, 1982. 47 FR 4751 (Feb. 2, 1982). Secretarial Order No. 3087, dated Dec. 3, 1982, then transferred onshore minerals management functions not related to royalty management from MMS to BLM. 48 FR 8983 (Mar. 2, 1983).

bonus $2,016.00 total or $64.41 per acre. The computer printout from the "Present Worth" (PW1) discounted cash flow "Monte Carlo" model is attached.

* * * * * * * *

* * * we have traced the steps of the original evaluator, and we can find no information which would have altered the estimate for bonus value as of October 27, 1982. At the time of the original valuation it was considered proper to use potential "Tonkawa" and "Morrow" production, with emphasis on "Tonkawa," as an indication of value. Our postsale analysis indicates that this is still a valid premise, and it will remain so until the subject section is tested by actual drilling. * * *

Since the high bid is substantially beneath the presale estimate, and since a postsale review indicates no reason to change, Mr. Johnson's high bid still is considered to be unacceptable within the meaning and intent of Section 17 of the Mineral Leasing Act of 1920, as amended. [Emphasis added.]

The original BLM rebuttal memorandum, dated April 25, 1983, stated in pertinent part:

[I]n addition to the direct responses to items of the appeal it is important to consider the two following factors:

1. There is a Morrow-producer approximately 1/2 mile west of Parcel 53 (see attachments). * * *

2. Previous sales data established values in Roger Mills County between $300 and $1000 per acre. Mr. Johnson's bid is only 20% of the minimum established price. [Emphasis added.]

The memorandum continued with the following statements made in answer to appellant's statement of reasons in the first appeal:

1. Parcel No. 53, in sec. 3, T. 16 N., R. 26 W. is in an undefined addition to the Crawford Field Known Geologic Structure (KGS) and is not an isolated undefined KGS as the appellant states. The completion for the Morrow well in Sec. 4, from Petroleum Information, Corp. records the field as being the Crawford NW Field; Dwight's Energy Data, Inc., also records this well as producing from the Crawford N.W. Field. * * * It is common for different producing zones to have the same field name suffixed with the formation name or series name to distinguish them. * * * There is thus no reason to presume that the Crawford N.W. Field name must be restricted to production from only one geologic formation as Mr. Johnson implies.

2. The MMS pre-sale evaluation was based primarily on Tonkawa data. The sedimentary section present here includes several potentially productive zones. Until a test hole is drilled, Tonkawa potential cannot be eliminated. * * *

3. * * *

Mr. Johnson states that recent bidding history is the best method for evaluation of tracts. Petroleum Land Data, Inc.'s U.S. Lease Price Report; (September, 1982; Vol 1, No. 3) recorded bids in Roger Mills County, for September. The highest bid received was $1,000 per acre, the lowest bid received was $300 per acre and the most common price paid (the mode) was $500 per acre. Mr. Johnson's bid of $64.41 per acre is clearly far below even the lowest bid received. Due to high potential for oil and gas in Roger Mills County, even the poorest locations are receiving at least $300 per acre. It is not reasonable to assume that a parcel adjacent to a known Morrow producer is worth only 20% as much as the least promising land in the county.

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5. Mr. Johnson contends that lease values are declining because of the present depression in the petroleum industry. * * * The evaluation for tract 53 clearly reflects the price established in the market place at the time of the sale. * * *

6. The appellant is critical of MMS for "grossly underestimating the cost of the Morrow tests." This is not true; in the MMS "Recommendation for Rejection of High Bid on Parcel No. 53" we listed the inputs used to derive the present worth for a Tonkawa gas well, not a Morrow gas well. * * * the drilling cost range of from $711,594 to $869,726 per well could only have been for an 8,000 foot deep Tonkawa well and not for a 14,000 feet deep Morrow well.

Mr. Johnson states that the costs of the Morrow well in Sec. 4 were estimated to be $6.655 million for an 18,375 foot well. * * * the actual well was completed at 14,070-14,090 feet, not 18,375 feet. Our cost estimate * * * for this well is $2.45 million.

7. * * * Taking a per-foot cost of an 18,000 foot well and applying it to a 14,000 foot well, as the ratio [BLM claimed appellant used] does, is not realistic. Because of factors such as increases in pressure, temperature, and time needed to pull drill stem and run tests, drilling costs progress geometrically with depth, not linearly. * * * Even assuming an additional $100,000 for acidizing and fracturing the reservoir, the total cost is less than half Mr. Johnson's calculated costs. * * *

* * * * * * *

8. The appellant states that 54.7 months is the minimum time to recoup $7.0 million in estimated costs; about 4-1/2 years at constant production levels. * * * To recover $5.0 million using appellant's figures yields a payout time of around 39 months, or

3-1/3 years. To recover the actual cost of a 14,000 foot Morrow well ($2.5 million) would take around 20 months, or 1-1/2 years based on appellant's own figures.

9. Mr. Johnson states that the extent of the Morrow is small. He cites data on a well in the NW 1/4 Sec. 9, T. 16 N., R. 26 W. as being the western boundary of the reservoir. However, this well was being tested at the time of the sale and plans to plug and abandon the hole did not develop until December (after the sale). A well approximately 1 mile N.E. of the parcel was unable to recover equipment lost in the well and was abandoned in 1979 after perforating and testing. However, no test data were released. The logs of this hole indicated several promising sandstone zones within the Morrow. The well in Sec. 4 was completed in August 1981 with an initial potential of 8,500,000 cubic feet of gas per day and had produced 437,000,000 cubic feet of gas in 10 months before the sale. Therefore, at the time of the evaluation, there was a producing well 1/2 mile southwest of tract 53 and a well being tested about one mile southwest of the tract.

According to MMS Resource Evaluation geologists in the Tulsa Minerals Management Office: "The limits and potential of the Morrow gas reservoir here is [sic] certainly not known at the present time. Some of the other sands in the 2,000 foot-thick Morrow formation may also prove to be productive here." They conclude that "a potentially large gas area could be present."

10. Mr. Johnson's assumption that there is "no chance for production" in the area of parcel 53 except from the Morrow, is unfounded. * * * The producing Morrow well in Sec. 4 contradicts Mr. Johnson's conclusion derived from Abel's and Slawson's works. This well proves that Morrow gas does exist and is found off structure in the area of parcel 53.

In discussing the high reservoir pressures, Mr. Johnson cites unique and risky drilling conditions. Hydrostatic pressure 1.25 times normal do not [sic] substantially increase risks or costs. Drilling techniques and equipment are routinely used in the Anadarko basin to handle twice normal pressures. * * * It can only be reiterated that typical drilling and completion costs pertaining to the Morrow have already been incorporated into cost estimates.

11. There is no evidence to indicate that Mr. Johnson would suffer any loss due to the shifting of the Canadian River. The tract has a "no surface occupancy" stipulation which was stated in the sale announcement. Consequently, he runs no risk of losing drilling or production equipment since it is not allowed to be there in the first place. Secondly, the spacing unit for a gas well is generally 640 acres. Therefore the holder of this lease will share proportionately in any well drilled in Sec. 3. [Emphasis added.]

In his statement of reasons for the appeal now before us appellant addresses the rebuttal memorandum which he admitted he had been "remiss" in not responding to in his first appeal (Statement of Reasons at 2). Appellant argues that BLM inappropriately used data from the Tonkawa reservoir because there is no chance for production from that reservoir in sec. 3. He asserts that only the Morrow formation has production potential in sec. 3 and that the Morrow formation has poor porosity and permeability. He argues BLM underestimated the cost of drilling a Morrow well in sec. 3, and used no Morrow wells when making its calculations. He emphasizes the potential for shrinkage of this parcel, due to movement of the Canadian River. Appellant also included a point-by-point response to the rebuttal memorandum quoted above. He stated:

> 1. Although I am not certain, the discovery in Sec. 4 had not been named by * * * the Mid-Continent Oil and Gas Association * * *. Petroleum Information, Inc., and Dwight's Energy Data, Inc., do not have the authority to name fields, and it is well known among the users of these services that they frequently use the wrong field names in their reports.
>
> The discovery in Sec. 4 was later called an extension of the Northwest Crawford Field which in my opinion was wrong because the discovery was about 2 miles from the known limits of the Northwest Crawford production as shown on Mr. Hager's and my maps and about the same distance from the KGS boundary of the field.
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> * * * * * * *
>
> Mr. Hager's argument suggests that because the discovery was placed in the Northwest Crawford Field, it should be productive from the Tonkawa zone. This is simply not true * * *.
>
> 2. * * * Tests all around Sec. 3 including the Morrow discovery in Sec. 4 show with considerable certainty that there is no potential for Tonkawa production in Sec. 3 or negligible at best. Therefore, Mr. Hager's statement that the evaluation was based primarily on Tonkawa data proves that their evaluation used the wrong data because the only potential indicated in Sec. 3 is for Morrow gas.
>
> 3. If the Albuquerque Regional office did have a new computer program, it will still give you the wrong answer when you use the wrong data. Mr. Hager has already admitted that they used the wrong data.
>
> Mr. Hager states that the Petroleum Land Data, Inc., U.S. Lease Price Report, (September 1982, Vol. 1, No. 3) showed the highest bid of $1000 per acre and the lowest bid of $300 per acre in Roger Mills County for evidently a 3-month period. This is very misleading information. Mr. Hager does not say where the lands were located that received the bonuses or that no leases

were taken in most of the county. The lands could be many miles across the county, and the only bidding information that is meaningful would be in the immediate vicinity of the tract. Mr. Hager also failed to say that the petroleum industry was in a severe depression in late 1982, and lease bonuses had dropped drastically by late October when I made my bid. Also, the September report undoubtedly showed prices paid in the summer of 1982. In fact, there were in October 1982 very few, if any, leases taken for deep prospects in Roger Mills and other counties in the Anadarko Basin.

* * * * * * *

5. My comment to this item is that historical data will show that Mr. Hager is wrong.

6. Again, Mr. Hager admits that his group used the wrong data, and consequently, the first paragraph under this item is meaningless.

Mr. Hager may have obtained his well cost for a Morrow well from the American Petroleum Institute, but my figure came from the cost estimate for the Morrow discovery in Sec. 4 by the company that drilled it. Obviously, my cost estimate was more reliable than Mr. Hager's costs. Furthermore, the well was drilled to 18,375 feet and plugged back at additional cost to about 14,000 feet. The cost for an 18,000-foot well should be used because the next operator should test all zones to that depth in Sec. 3.

7. Although Mr. Hager is correct that drilling costs progress geometrically with depth, my cost estimate is still much more realistic than his according to data provided by the Oklahoma-Kansas Oil and Gas Association. Moreover, Mr. Hager has not used his or my estimate for a Morrow well in his evaluation, and one or the other would make a considerable difference in the computer evaluation.

8. As stated above Mr. Hager's cost estimate is about half of the actual estimate, and a 39-month payout is still considered a poor risk by industry standards.

9. I do not know why the Tulsa office states that the Morrow reservoir could be large and then show the limits of a relatively small reservoir on their map. Furthermore, if other Morrow sands were to be productive, they would have been found in the discovery well in Sec. 4 and the dry and abandoned test in Sec. 9. Refer to item 10 in my first appeal which shows that other geologists believe that the potential for Morrow production is poor in this area.

10. My original assumption was correct because 18,000 feet of sedimentary section have already been tested in Sec. 4, and

zones deeper than 18,000 feet have not been productive in this part of the county.

In the second paragraph of this item, Mr. Hager's statements and presumptions are totally wrong. The data supplied by me is correct and can be found in the Tulsa Office of the BLM (formerly Geological Survey) on an abnormal pressure map and completion cards by Petroleum Information, Inc.

11. Mr. Hager evidently has no knowledge of the Oklahoma laws concerning lands abutting a river. As the river cuts away the Federal lot I will lose mineral acreage, and if the lot is washed away, mineral ownership of the lot which would be in the river bottom would be riparian to the private landowner adjacent to the Federal tract. The Federal mineral interest would therefore be lost.

On the first page of Mr. Hager's letter he asked you to consider two important factors, and the following are my comments on those factors:

1. I would essentially agree with this statement, but he should have used the word "indicates" instead of "proves". Nothing is proven until a test is drilled in Sec. 3. So far, the discovery in Sec. 4 does not have a confirmation well. Furthermore, if Mr. Hager believes that the tract has Morrow potential, why did not not use Morrow data in the computer program?

2. The sale data shown in this paragraph is meaningless unless it is in the immediate vicinity of Sec. 3. Moreover, I do not believe that these bids were made in September 1982 and suspect that they were many miles from the area in a large active field. [Emphasis added.]

[1] As this Board stated in Edward L. Johnson, supra at pages 254-55:

The Secretary of the Interior has discretionary authority to reject a high bid for a competitive oil and gas lease as inadequate. 30 U.S.C. § 226(b) [1982]; 43 CFR 3120.3-1 [(1982) 3/]. This Board has consistently upheld that authority so long as there is rational basis for the conclusion that the highest bid does not represent a fair market value for the parcel. Read and Stevens, Inc., 70 IBLA 377 (1983); Harris-Headrick, 66 IBLA 84 (1982); Frances J. Richmond, 29 IBLA 137 (1977).

The Department is entitled to rely on the reasoned analysis by its technical experts in matters concerning geologic evaluation of tracts of land offered /at a sale of competitive oil and gas leases. Dan Nelson, 85 IBLA 156 (1985); L. B. Blake, 67 IBLA 103 (1982). However, when BLM relies on that analysis in rejecting a bid as inadequate, it must ensure that a reasoned

3/ Now 43 CFR 3120.5(a).

explanation is provided for the record to support the decision. Harris-Headrick, supra at 86; Southern Union Exploration Co., 41 IBLA 81, 83 (1979). When the record does indicate a decision to reject a bid has been made in a careful and systematic manner utilizing the advice of such experts, that decision will not be reversed, even though the determination may be subject to reasonable differences of opinion. See Kerr-McGee Corp. v. Watt, 517 F. Supp. 1209, 1213-14 (D.D.C. 1981).

The Secretary of his delegate need not prove a bid is inadequate in order to support a rejection decision. A rejection is an exercise of his discretion, and deference is given to such action if, in the public interest, the Secretary determines a bid to be less than the estimated fair market value. The record need only be sufficient to establish a rational basis for the determination. Viking Resources Corp., 80 IBLA 245, 246 (1984); Ambra Oil & Gas Co., 75 IBLA 11, 14 (1983); Kerr-McGee Corp., 6 IBLA 108 (1972), aff'd, Kerr-McGee Corp. v. Morton, 527 F.2d 838 (D.C. Cir. 1975).

[2] The Board has repeatedly stressed the need for BLM to document the reasons for its determination in the record. Such was initially the case here. In Edward L. Johnson, supra, the records were insufficient for the Board to determine the correctness of the BLM decisions or the merits of appellant's arguments. BLM was given specific instructions as to what it was to do on remand:

> A post-sale evaluation will be made, and appellant's bid will be re-adjudicated on the basis of the figure thus derived. Should the bid again be rejected, the record submitted to this Board on appeal shall be complete, with no omissions, exclusions or deletions of any documents or data, and will specifically include all actual amounts of pre- and post-sale evaluations. [Emphasis added.]

Edward L. Johnson, supra at 257. Rather than conducting a systematic post-sale evaluation, adjusting the fair market value figure to compensate for any errors which might have been made in the presale valuation, BLM merely supplemented the record with presale evaluation information for the parcel and affirmed its initial decision. 4/ In doing so, BLM chose to retain the fair market value estimate of $1,000 per acre. Therefore, on appeal appellant has an affirmative obligation to demonstrate that the Government estimate is inaccurate and that his bid represents fair market value. The Westlands Co., 83 IBLA 43, 45 (1984).

4/ The policy for onshore competitive leasing provides for post-sale review. In part, the stated policy is that

"[i]f the reviewer determines that the initial appraisal report was adequate, or would be adequate with only technical adjustments not affecting value, then he/she would provide a certification that the PEV [pre-sale estimate of value] should serve as the official estimate of value (independently confirmed PEV = FTV). Where the PEV cannot be so confirmed the reviewer may develop and present a final appraised value (FAV) using either of the approved apprisal methodologies."

Instruction Memorandum No. 85-182, Enclosure 1-1, at 22 (Dec. 20, 1984, emphasis added).

Appellant appropriately questions BLM's use of Tonkawa cost data for a Morrow well. Like appellant, we are disturbed by the apparent inconsistencies in the supporting data BLM presented. Appellant correctly points out that cost calculations were primarily based upon the shallower Tonkawa formation rather than the deeper Morrow. However, in subsequently filed documents BLM repeatedly emphasized that the Morrow was the target formation. See Rebuttal Memorandum (Apr. 25, 1983). Clearly, if the fair market value of the lease is properly based upon contemplation of a well to a much deeper, and therefore "geometrically more costly" well, the earlier fair market value of $1,000 per acre is in error. By BLM's own admission, the cost of a well to the Morrow formation will be at least three times the cost used in the Monte Carlo determination of fair market value. Yet, in its "post-sale valuation" which was to be conducted in accordance with the direction of this Board, no adjustment was made. We find appellant has carried the first burden set forth in The Westlands, supra, i.e., appellant has demonstrated that the Government's estimate was inaccurate.

In the past, the Board has held that when BLM's decision to reject a high bid is conclusory, without factual basis in the record, and a request for supporting documentation has been refused, the decision may be reversed as arbitrary and capricious, and lease issuance ordered. Steven Lutz, 39 IBLA 386, 389 (1979). However, since the Lutz decision, the Board has determined, as set forth above, that a lease may not issue until the high bidder shows BLM's minimum acceptable bid value was erroneous and affirmatively shows its bid represents fair market value for the parcel. Thus, where BLM fails to provide a rational basis for its rejection decision or where appellant shows BLM has erred in its calculation of a minimum acceptable bid value, the Board must also be satisfied that appellant's bid represents fair market value in order to be awarded the lease. Harold Green v. BLM, 93 IBLA 237, 247 (1986).

While appellant has supported his calculations by reference to industry publications and other documents, these documents have not been made a part of the record, and we do not, therefore, find sufficient evidence in the record to conclude appellant has carried his burden of proof that his bid represented the fair market value on the date of the sale. 5/ Inasmuch as we have afforded BLM the opportunity to supplement the record in support of its rejection, we believe it equitable to afford appellant a similar opportunity. Where there are disputed facts determinative of the legal issues posed therefrom, this Board has the discretionary authority to order a hearing on the matter before an Administrative Law Judge pursuant to 43 CFR 4.415. Patricia C. Alker, 70 IBLA 211 (1983). We deem this to be such a case.

Accordingly, pursuant to 43 CFR 4.415, we refer the matter to the Hearings Division for assignment to an Administrative Law Judge who will convene a hearing at a place most convenient for presentation of evidence concerning whether a value of $64.41 per acre represented the fair market value f

5/ For example, there is a question as to the cost of drilling a Morrow well, and the difference between $6 million and $2 million would have a direct effect on the fair market value of the tract.

parcel 53 in the lease sale held October 27, 1982. Appellant shall have the burden of showing this value did, in fact, represent the fair market value for the tract on that date. The Judge will issue a decision determining whether appellant's bid is acceptable, which, in the absence of a timely appeal to this Board, will be final for the Department.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the New Mexico State Office is set aside and the case is referred for a hearing.

R. W. Mullen
Administrative Judge

We concur:

Bruce R. Harris
Administrative Judge

C. Randall Grant
Jr., Administrative Judge.